
CHAPTER 1. ADMINISTRATION

- 1-1. INTRODUCTION. Section 213 (i) of the National Housing Act authorizes HUD-FHA to insure a project mortgage on existing construction under Section 213. The statutory language reads as follows:

"(i) Nothing in this Act shall be construed to prevent the insurance of a mortgage executed by a mortgagor of the character described in paragraph (1) of subsection (a) of this section covering property upon which dwelling units and related facilities have been constructed prior to the filing of the application for mortgage insurance hereunder; Provided, that the Assistant Secretary-FHA Commissioner determines that the consumer interest is protected and that the mortgagor will be a consumer cooperative. In the case of properties other than new construction the limitations in this section upon the amount of the mortgage shall be based upon the appraised value of the property for continued use as a cooperative rather than upon the Assistant Secretary-FHA Commissioner's estimate of the replacement cost. As to any project on which construction was commenced after the effective date of this subsection, (September 23, 1959), the mortgage on such project shall be eligible for insurance under this section only in those cases where the construction was subject to inspection by the Assistant Secretary-FHA Commissioner and where there was compliance with the provision of Section 212 of this title. As to any project on which construction was commenced prior to the effective date of this subsection, such inspection, and compliance with the provisions of Section 212 of this title, shall not be a prerequisite."

- 1-2. ELIGIBILITY. The mortgagor must be a consumer cooperative of the management type. Sales type and investor-sponsor mortgagors are not eligible under Section 213 (i) procedures. See discussion to follow concerning Rehabilitation loans where a minimum of 25% of mortgage proceeds will be used in rehabilitation.

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- 1-3. APPRAISAL OF PROPERTY. The mortgage in this type of project is based upon the appraised value of the property for continued use as a cooperative rather than upon the Assistant Secretary-Commissioner's estimate of the replacement cost.
- 1-4. PERCENTAGE OF REHABILITATION. Under the "Existing Construction" legislation, no specific percentage of repairs is required. Existing Construction processing should be followed, regardless of the percentage of repair, where construction of the project was commenced prior to September 23, 1959, or thereafter, if the construction was subject to inspection by HUD-FHA and there was compliance with Section 212 prevailing wage requirements. Projects where construction was commenced after September 23, 1959, and where there was no HUD-FHA inspection or compliance with prevailing wage requirements, are not eligible as "Existing Construction" projects but are eligible as "Rehabilitation" projects provided a substantial degree of rehabilitation is involved.
- 1-5. PREVAILING WAGE REQUIREMENTS. As to projects in which construction was commenced prior to September 23, 1959, it is immaterial whether prevailing wages were paid in connection with the existing construction or whether the project was inspected during construction by HUD-FHA. In other words, projects started prior to September 23, 1959, are eligible regardless of whether or not they were "FHA" projects. Any project started after September 23, 1959, must have been built under one of HUD-FHA programs in order to be eligible.
- a. Repair or Renovation After an Application for Insurance
If any HUD-FHA required or approved repair or renovation takes place after an application for insurance is filed under this legislation, such repair or renovation is subject to both HUD-FHA inspection and prevailing wage requirements.
 - b. Essential Items. If the items are deemed essential to the HUD-FHA valuation or deemed essential to the eligibility of the project, they should be included in the commitment and such inclusion will subject them to prevailing wage requirements.
 - c. Normal Maintenance. If, however, the repair item is one involving normal maintenance for which HUD-FHA would give no effect in its valuation or would not require as a

condition of eligibility, then such repair item should not be included in the processing of the case and should not be a condition of the commitment.

- (1) Its non-inclusion in HUD-FHA processing is largely one for determination by the local office.
- (2) Such items may be handled by the purchasing cooperative under an agreement with the seller and may be the subject of one of the customary clauses in Sales Agreements whereby the purchaser lists a series of normal maintenance items to be accomplished before consummating sale.
- (3) Items of this nature are not subject to prevailing wage requirements.

d. Work Accomplished Prior to Application For Insurance
Work of any nature accomplished prior to the tiling of the application for insurance is not subject to HUD-FHA inspection during construction or prevailing wage requirements.

1-6. COST CERTIFICATION. Section 227 (Cost Certification) is not applicable to existing construction projects.

1-7. DETERMINATION OF FEASIBILITY. The considerations set forth in Reference (1) of the Foreword are applicable, but since the statute requires HUD-FHA to determine that the consumer interest is protected in determining feasibility in "existing" projects, the following additional factors must be taken into consideration, even though it may be in conflict with HUD 4420.1.

a. Project History. The history of the project should be ascertained and analyzed. If the project is satisfactorily located and has been operating successfully as a rental project with no record of defaults, in all likelihood it can be made into a successful cooperative. On the other hand, if the project has not been successful on a rental basis and/or if there have been defaults in its mortgage obligations, the Director should not find the project feasible for cooperative purposes unless he is satisfied that the circumstances which contributed to the failure on a rental basis will not be present the proposed cooperative plan. For example, if it is

determined that the project did not fare well as a rental project because the rental rate was too high, a finding of feasibility may be made if an analysis of project debt service and operating costs indicates that the monthly housing costs to the members under the cooperative plan will be sufficiently below competitive rentals in the area to make it attractive in the market. In other words, the Director should determine that the undertaking will be a "good deal" for the cooperative and its members and not merely a device for property owners to dispose of undesirable or uneconomic housing.

- b. Physical Condition. Another element to be taken into consideration in determining feasibility is the physical condition of the structures involved. The construction must be sound and in good state of repair. If this is not the case, but in the judgement of the technical staff of the insuring office can be made so, FHA Commitment Form No. 3248A should be used which will set forth the repairs or renovation which must be effected as a condition to our insuring of the mortgage. When no repair or renovation is involved, Commitment Form No. 3248 is used. There may be items which are estimated to have a relatively short remaining useful life but where immediate replacement would not be warranted. HUD-FHA processing procedures in appropriate situations of this kind provide for the inclusion in mortgage proceeds of an amount to be escrowed which together with reserves to be accumulated will provide for replacement when needed.
 - c. Accommodations and Appearance. In addition to being sound and in good state of repair, the property should be reasonably modern and attractive in its accommodations and appearance or it must be made so as a condition of the insurance. (If feasible to do so, a community center should be included.) It is not possible to set forth specifically what is needed in this connection but the Director should determine that the property is reasonably competitive in the housing market.
- 1-8. CONSUMER SAFEGUARDS. The usual consumer safeguards required in Section 213 will be applicable. Thus, an Information Bulletin Subscription Agreement, Occupancy Agreement and Sales Agreement must have been approved by the Field Office and satisfactory assurance of permanent financing must have been obtained prior to solicitation for members in the cooperative. As further

protection, the report of an independent licensed mechanical engineer covering the condition of the premises is required and the cooperative must be represented by an independent attorney. A condition of the commitment provides that the purchase price of the real estate may not exceed the sum of \$_____ (the figure to be inserted by the local Field Office). The purpose of this provision is to preclude the cooperative from paying an inflated price for the property. The figure to be inserted by the local Field Office should be the amount indicated by the parties in the application as being the price which the cooperative is to pay for the property, except that it is expected that the amount inserted will not exceed 110 percent of HUD-FHA's valuation of the physical property. The 10 percent flexibility is provided since it is recognized that real estate appraisal is not an exact science and honest differences of opinion to a certain degree may exist. Where the Director feels that circumstances warrant a figure in excess of the 10 percent limitation, he should forward his findings and recommendations to the Office of the Director of Unsubsidized Insured Housing Programs prior to the issuance of the Commitment.

- 1-9. TENANTS. It is not HUD's intention to cause any undue displacement of tenants. Therefore, the commitment provides that any tenants of the property must be given a 30-day priority to apply for membership in the cooperative. The cooperative is not obligated to accept such applications but it is expected that the cooperative will be fair in passing on same. In fact, since the objective is not to bring about the eviction of tenants unnecessarily, it is expected that the cooperative will accord considerable weight to a satisfactory rental payment record of such tenants in passing upon their credit qualifications.
- 1-10. CREDIT APPROVAL. Members of the cooperative will be subject to HUD-FHA credit clearance.
- 1-11. INITIATING THE PROJECT AND SPONSORSHIP OF THE ACQUIRING COOPERATIVE.
 - a. With regard to who is to form the consumer cooperative, it is recognized that existing construction differs from new construction. The owner of the premises must almost necessarily take the initiative as there is no reason for any cooperative to be formed unless the owner has indicated

an intention to sell the premises. It is proper for the owner to file an application with HUD-FHA on the basis of the sale he contemplates and to obtain a commitment for insurance from HUD-FHA. He may also properly assemble the tenants and inform them of his planned sale, the dollar amount and other details. However, he will not be permitted to become an officer or director of the cooperative corporation that is to acquire the project.

- b. An attorney, independent of the seller, that is knowledgeable about cooperative documents must be retained on behalf of the cooperative group. Cooperatives may establish a steering committee under the guidance of a professional management firm, knowledgeable with regard to cooperatives, conduct a sales campaign and handle its organizational details either directly as a group of consumers, or it may retain an organization which is competent in this field (See Reference (2) of the Foreword). If the owner/seller is himself involved in the selling effort neither he nor any entity with which he is connected should be permitted a marketing fee for such services, but he may properly be reimbursed for out-of-pocket expenses.
- 1-12. PRESALE REQUIREMENTS. Cooperative membership equal to all vacated or available units in the project, but in no event less than 70% of the total units in the project, must be and approved by HUD/FHA prior to endorsement. It is recognized that existing rental leases sometimes expire on a staggered basis and thus all of the units may not be immediately available for cooperative occupancy. The estimated income from the units which have been subscribed on a cooperative basis when added to rental income from nonmember tenants must be sufficient to meet the estimated operating expenses of the project.
- 1-13. MODEL FORMS, DOCUMENTS AND PROCEDURES USED IN SECTION 213(i) CASES. The Management Type Cooperative forms, documents and procedures are applicable, except as noted in this Chapter. Forms necessary to the conversion of existing properties under Section 213(i) are contained in the Forms Appendix of this handbook. Articles of Incorporation, By-Laws, etc., which are commonly used to establish the corporate entity, are duplicated in Reference (2) of the Foreword for ease of utilization. The Forms contain much detail which could not otherwise be placed in its proper context and they should be studied accordingly.

1-14. PRINCIPAL DIFFERENCES IN DOCUMENTS, FORMS AND PROCEDURES FOR 213(i).

a. Commitments.

- (1) Insured Advances: Where repairs or renovation is to be effected with the aid of insured mortgage advances, the commitment form to be used is Commitment for Insurance of Advances (Existing Construction Involving Improvements), FHA Form 3248-A. Under Commitment Form 3248-A, which involves interim advances to effect repairs or improvements, there will be both an initial and final endorsement. The closing check list applicable to initial endorsement is FHA Form 3257-B. Under Commitment Form 3248, there will be no interim advances and only one insurance endorsement. The instructions covering this transaction will therefore be set forth in Reference (3) of the Foreword.
- (2) Insurance Upon Completion. Where no insured advances are involved, the appropriate form is Commitment to Insure Mortgage on Existing Construction (Not Involving Commissioner Approves repairs), FHA Form No. 3248.
- (3) Commitment Amount. In the case of existing construction projects insured under the provisions of Section 213(i) of the National Housing Act, the loan percentage is applied against the HUD-FHA appraised value for continued use as a cooperative rather than against replacement cost, and as set forth in the underwriting instructions, the bedroom limitation is not applicable. In situations where a sound reason exists for same, as for example where the existing structure contains oversized rooms as compared with HUD-FHA requirements for new construction, it would be proper for the commitment amount to reflect such amenities. The amount may not, however, exceed 97% of appraised value for continued use as a cooperative.

b. Building and Loan Agreement, FHA Form No. 2441. In existing construction projects under Commitment Form 3248-A, the following cost certification provision should be deleted:

- (1) Final eight words of Paragraph (13).

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- (2) Paragraph (18) in its entirety.

- c. Amortization Term. In existing construction cases, in view of the fact that the structures are not new, the amortization term may or may not be less than the maximum, as described in underwriting instructions (See Reference (3) of the Foreword).
 - d. Model Form of Sales Agreement, Existing Construction Cases Under Section 213(i), FHA Form 3255-B. This form is self-explanatory.
 - e. Mortgagor's Certificate, FHA Form No. 3212-B. This form is used in Section 213 Existing Construction cases.
- 1-15. REHABILITATION LOANS. Certain residential properties when rehabilitated, or certain commercial and industrial properties when converted, for the purpose of creating cooperative housing units may be eligible for mortgage insurance under Section 213. Such properties must be located in areas adaptable to rehabilitation of residential properties, and upon completion shall provide modern and sanitary living units having stable occupancy appeal which will compete favorably in the housing market in the area.
- a. The Following Types of properties in the rental or sales market containing, after remodeling, at least five dwelling units are among those eligible under this program:
 - (1) A existing residential property which can be remodeled to provide additional modern dwelling units;
 - (2) An existing residential property lacking modern living units, even though no additional units are added; and
 - (3) Nonresidential properties located in areas which are acceptable for residential use, if they can be transformed into sanitary living units.
 - b. The Rehabilitation of Properties should lend impetus to the improvement of similar properties in the same neighborhood. The total carrying charges for cooperative dwelling units should be less than the rents charged for comparable units in rental projects.

- c. Construction Advances for the portion of a rehabilitation project representing new construction may be insured in the usual manner. At the time of closing, it must be

established that the purchase of land and existing improvements thereon has been consummated and that the property is free and clear of liens or outstanding obligations in connection therewith.

- d. To Qualify as a rehabilitation project, at least 25 percent of the mortgage proceeds to be insured must be used to cover the cost of new physical improvements. In cases where less than 25 percent of the mortgage proceeds is needed for this purpose, the loan may be insured under the "existing construction" authority as described above.
- e. The Application for Mortgage Insurance, FHA Form 3201, will be used for rehabilitation projects, whereon, it will be indicated as to whether the project will be initiated as a Management Type or Investor-Sponsor under Section 213 or Management Type, Investor or Nonprofit Sponsor under Section 221(d)(3) Market Interest Rate. Any additional data concerning these projects for which no provision is made on the application form will be set forth on blank sheets and attached to and made part of the application under the heading "Additional Information".
- f. Detailed Instructions and Procedures have not been established for this type of project and for that reason commitments will be issued only after clearance by the Office of the Director of Unsubsidized Insured Housing Programs.